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PP RUEHCHI RUEHDT RUEHFK RUEHHM RUEHKS RUEHNAG RUEHNH RUEHPB
DE RUEHHI #0138/01 0500956
ZNR UUUUU ZZH
P 190956Z FEB 09
FM AMEMBASSY HANOI
TO RUEHC/SECSTATE WASHDC PRIORITY 9157
INFO RUEHHM/AMCONSUL HO CHI MINH 5584
RUEHGP/AMEMBASSY SINGAPORE 2750
RUCNASE/ASEAN MEMBER COLLECTIVE
RUEHZU/ASIAN PACIFIC ECONOMIC COOPERATION
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCPDO/DEPT OF COMMERCE WASHINGTON DC

UNCLAS SECTION 01 OF 02 HANOI 000138

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E.O. 12958: N/A
TAGS: [EINV](#) [ECON](#) [VM](#)
SUBJECT: GVN ROLLS OUT STIMULUS PACKAGE

REF: A) Hanoi 1391 - "Further Effects of the U.S. Financial..."
B) Hanoi 1196 - "VN's SMEs Thirsty for Capital"

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¶1. (SBU) Summary. The GVN is in the process of implementing its stimulus package. The package consists of three main parts; USD 1 billion in interest rate subsidies, one-time payments to poor families, and reductions in the value-added, corporate and personal income taxes. Additional measures are being announced on an ad-hoc basis by various ministries and agencies. While some are optimistic that the plan may help businesses survive the economic downturn, others foresee implementation issues and financing concerns. End summary.

¶2. (U) The GVN is beginning to implement its much-discussed stimulus package (reftel A). The centerpiece of the package is USD 1 billion in interest rate subsidies, available to all businesses except consumer goods importers and securities investors and brokers. Commercial banks will deduct 4 percentage points from their ordinary lending rates and then request compensation from the GVN for that amount. It will apply to new loans only and the subsidy will be paid for a maximum of eight months. The program technically began on February 1 and will be in place through December 31, 2009, but no banks have applied for the subsidy to date because implementing directives were not released until last week. Banks have begun to announce "set asides" for lending at the subsidized rate. The Bank for Investment and Development (BIDV), a state owned commercial bank, says it has up to VND 65-68 trillion (USD 3.73-3.91 billion) available, and may make adjustments to loan contracts signed before February 1. Privately-held Asia Commercial Bank will lend up to VND 35 trillion (USD 2.01 billion) at the subsidized rate.

¶3. (U) The second part of the package, aimed at Vietnam's poorest citizens, provides for one time payments of VND 200,000 per person (about USD 11.50), but not to exceed VND 1 million (USD 57) per family, to families earning less than VND 1 million (USD 57) per year. The GVN estimates that total cost for this fund will be about VND 3,800 billion (USD 217 million). Most of these payments were made during the Tet holiday at the end of January.

¶4. (U) The third part of the package is a 50 percent VAT reduction for certain sectors and industries, effective February 1 through December 31, 2009. The reduction is narrowly focused on industrial inputs such as coal, basic chemicals, machinery, some types of vehicles and related components (such as engines and gear boxes), ships and boats, cargo handling, hotel and tourism services. The GVN also enacted a 30 percent reduction in the corporate income tax (CIT) on small and medium sized-enterprises (SMEs) and businesses

operating in some sectors such as agriculture-forestry-fishery, textile and garment, footwear and electronics. The reduction applies retroactively for the fourth quarter of 2008 and for all of 2009. Some other sectors, such as machine manufacturing, building materials, construction and installation services, tourism, food and fertilizer trading may defer payment of the CIT for nine months. Finally, implementation of the new personal income tax has been delayed until May.

15. (SBU) In addition to the formally announced initial stimulus package, some ministries and agencies are beginning to develop complementary initiatives. Some public investment infrastructure projects that were delayed last year as part of the fight against inflation will be revitalized in an effort to create jobs and spur spending, but no new funds will be allocated from either the budget or off-budget accounts. In a move aimed at stimulating public consumption, the SBV issued a circular, effective February 1, that allows banks and their retail customers to negotiate borrowing interest rates (based on market rates) for consumer credit. The cap on lending rates (150 percent of the SBV's base rate), however, is still in place and applies to corporate lending. The Ministry of Finance has also extended the deadline for paying taxes on imported materials used in the production of exports by 275 days from the date customs procedures are completed. Finally, Ho Chi Minh City is in the process of unveiling its own package, which will likely consist of already-planned infrastructure spending re-bundled as a "stimulus plan." Several other southern provinces confirm that they are already reprogramming their budgets to put money into the hands of businesses and the poor, in addition to any stimulus funds they may receive from the central government.

THE DEVIL IS IN THE DETAILS

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16. (SBU) According to the Director of Macroeconomic Policy at the Central Institute for Economic Management (CIEM), a GVN-sponsored analysis and forecasting group, the purpose of the interest rate subsidy is to allow businesses to continue operations during what will likely be a difficult period, thereby preventing layoffs. He doesn't foresee many businesses using the money to expand operations or increase investment, and expressed some doubt that commercial loans would find many takers even at reduced rates, saying "People don't even have business plans for 2009 - they just don't know what is coming." He also expressed doubt about the effectiveness of the VAT cut, noting that sector-based reductions are difficult to administer and often invite fraud.

17. (SBU) Local bankers and businesses are more hopeful about the program's ability to spur economic growth. The head of Vietnam's SME Association thinks that the plan has the potential to make a meaningful difference for Vietnam's struggling SMEs, which have recently struggled with access to capital. (reftel B) Some bankers worry, however, that implementation may be challenging. The SBV must still approve each loan, and if it decides that a project doesn't meet requirements for a subsidy, lenders are stuck with the 4 percent loss. The head of a foreign bank operating in Vietnam tells us that there is considerable pressure on banks to make riskier loans under the new program, and worries that a portion of the funds will find their way back into Vietnam's bubble-prone real estate market. Finally, the interest rate subsidy will only be paid for eight months and does not require any structural adjustment by borrowers, so if the current downturn lasts into 2010, businesses will be no better equipped to cope with difficulty than they are now.

COMMENT

18. (SBU) A larger concern is how the stimulus plan will be funded. While there may be some funds available in the GVN coffers for the interest rate subsidy portion of the plan, there has been no public cost estimate, nor a revised state budget, that accounts for the revenue side of the package. The IMF Resident Representative notes that the initial budget for 2009 already carried significant

financing requirements (approximately VND 52 trillion, or USD 3 billion, which equals 2.9 percent of GDP by international standards or 4.8 percent of GDP by Vietnamese standards). A substantial decrease in oil revenues because of declining oil prices combined with falling revenues resulting from less economic activity and the tax cuts discussed above will result in an even larger deficit. The PM recently issued a directive to the MOF to undertake a dollar-denominated domestic bond issuance to help cover this shortfall, but it's not yet clear how big (or successful) the issuance will be, especially with dollars in short supply on the local market. For its part, MOF has been reluctant to discuss details of how the package will be financed, which only creates more questions about who is charged with balancing the books.

19. (U) This cable was coordinated with Con Gen HCMC.

MICHALAK